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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION – **E-FILING**

DAVID KAYNE, an individual citizen of Georgia,

Plaintiff,

vs.

THE THOMAS KINKADE COMPANY, formerly known as MEDIA ARTS GROUP, INC., a Delaware Corporation,

Defendant.

Case No. C 07-4721 JF (RS)

PLAINTIFF DAVID KAYNE'S REPLY BRIEF IN SUPPORT OF MOTION FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION

Hearing Date: Submitted 10/5/07
Hearing Time: n.a.
Courtroom: 3, 5th Floor

I. PRELIMINARY STATEMENT IN REPLY

Defendant The Thomas Kinkade Company ("TKC") has filed both an opposition to plaintiff's request for injunctive relief and (as of today) an overlapping and largely similar motion to dismiss the complaint herein under Rule 12(b)(6), noticed for hearing on November 30, 2007. It is not the function of this reply brief to address at this time all of the issues raised by TKC in its motion. Mr. Kayne has substantial disagreements with the arguments presented in TKC's motion and intends to present those in his opposition to TKC's motion on November 9. The function of this reply brief is to focus on key issues surrounding Mr. Kayne's request for interim relief, in the form of injunctive relief to preserve the *status quo*.

The U.S. Supreme Court has stated that: "Because res judicata may govern grounds and defenses not previously litigated, however, it blockades unexplored paths that may lead to truth. For the sake of repose, res judicata shields the fraud and the cheat as well as the honest person. It therefore is to be invoked only after careful inquiry." *Brown v. Felsen*, 442 U.S. 127, 132 (1979). As noted by the Ninth Circuit in *Clark v. Bear Stearns & Co.*, 966 F.2d 1318, 1321 (9th Cir. 1992):

> The party asserting preclusion bears the burden of showing with clarity and certainty what was determined by the prior judgment. *United States v. Lasky*, 600 F.2d 765, 769 (9th Cir.), *cert. denied*, 444 U.S. 979 . . . (1979). "It is not enough that the party introduce the decision of the prior court; rather, the party must introduce a sufficient record of the prior proceeding to enable the trial court to pinpoint the exact issues previously litigated." *Id.*
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> . . . .
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> By definition, res judicata bars only those grounds for recovery which could have been asserted in the prior litigation. . . . If a claim could not have been asserted in prior litigation, no interests are served by precluding that claim in later litigation.

Here, TKC has not shown a high likelihood of meeting these tests for the purposes of injunctive relief, particularly bearing in mind that it will suffer no cognizable harm if its arbitration is merely delayed beyond the November 30 hearing date on its now-filed motion to dismiss.

TKC's response to Mr. Kayne's challenge to its unconscionable "expedited" arbitration procedure is long on explanations as to why Mr. Kayne should now be precluded from making this argument and very short on explanations of why TKC's effort to apply its "no witness" procedure in a yet-to-be-conducted arbitration is not unconscionable. TKC seeks to side-step the truth by pretending that the issue of unconscionability was or "should have been" raised before Judge Pannell, even though the argument did not exist until the Ninth Circuit's decision in *Nagrampa v. Mailcoups, Inc.*, 469 F.3d 1257 (9th Cir. 1997) ("*Nagrampa*"). For the reasons set out

below (and to be expanded in Mr. Kayne's November 9 opposition to TKC's motion to dismiss), TKC should not be allowed to get away with this.

II. UNDER THE NINTH CIRCUIT'S FOUR-PART TEST, THE MATTERS RAISED IN THE PRESENT ACTION ARE NOT THE SAME AS THOSE BEFORE JUDGE PANNELL

At the outset, it is important to note that "[b]ecause res judicata is a defense, [the courts] view all facts in the light most favorable to the plaintiff." *Chao v. A-One Medical Services, Inc.*, 346 F.3d 908, 921 (9th Cir. 2003). It also is noteworthy that Mr. Kayne's unconscionability claim is not a claim or cause of action for which he is seeking money damages from TKC, but is instead a recently-recognized *defense* to an arbitration that has not yet occurred.

One of the few areas of agreement between Mr. Kayne and TKC is that the Ninth Circuit has recognized a four-part test in determining whether successive actions involve the same cause of action: "(1) whether the rights or interests established in the prior judgment would be destroyed or impaired by prosecution of the second action; (2) whether substantially the same evidence is presented in the two actions; (3) whether the two suits involve infringement of the same right; and (4) whether the two suits arise out of the same transactional nucleus of facts." *In re International Neutronics, Inc.*, 28 F.3d 965, 969 (9th Cir. 1994), *citing Clark v. Bear Stearns & Co., supra,* 966 F.2d at 1320. These factors must be examined subject to the *caveat* that, by definition, res judicata "bars only those grounds for recovery which could have been asserted in the prior litigation"; here, such grounds could not have been asserted because they did not exist.

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A. The Limited Rights and Interests Established in the Georgia Litigation Will Not Be Impaired by Examining the Unconscionability of the "Expedited" Arbitration Clause

At issue in the Georgia litigation was the question whether the "Personal Guaranty" accompanying the "Application for Credit" were the following issues: (1) Whether the "Personal Guaranty" was supported by consideration; (2) Whether the "Personal Guaranty" had been accepted by TKC; and (3) Whether the reference in the "Personal Guaranty" to "the above arbitration clause" (in the "Application for Credit") constituted an agreement by Mr. Kayne to arbitrate issues of his personal liability under the Guaranty. Mr. Kayne acknowledges that Judge Pannell ruled against him on these issues and that the Eleventh Circuit has just affirmed those rulings.[1] As the Eleventh Circuit's decision confirms, however, the issues presented in the Georgia litigation involved only the foregoing issues as to whether an agreement was formed between Mr. Kayne and TKC, and not the entirely separate question – presented for the first time by the Ninth Circuit's decision in *Nagrampa* well after the Georgia case had been submitted to Judge Pannell – as to whether such an agreement, if formed, is *unconscionable*.

The Georgia litigation established that TKC had a contract with Mr. Kayne, in the form of a "Personal Guaranty", calling for arbitration of disputes arising under the "Personal Guaranty". This finding, as such, would not be affected by the limited relief that Mr. Kayne seeks here, which is a determination that the arbitration clause in the agreement is unconscionable.

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[1] Counsel for TKC have supplied a copy of the Eleventh Circuit's ruling in the supplemental declaration of Charles E. Weir relating to Mr. Kayne's motion, filed today. (Document 33).

B. Different Evidence Is at Issue Here

In the Georgia action, the evidence necessarily focused on whether TKC had given consideration in exchange for the Personal Guaranty signed by Mr. Kayne, and in particular whether it had extended credit to Mr. Kayne personally as a suitable form of acceptance. *See* the Eleventh Circuit's decision (Document 33 in these proceedings). Also at issue in the Georgia proceedings was whether the arbitration clause applied, by its terms, to Mr. Kayne personally. None of those issues is present in the instant action, which involves entirely separate issues that *assume* the existence of an agreement between Mr. Kayne and TKC to arbitrate, but present distinct issues not addressed in the Georgia decision, such as: (1) The procedural unconscionability that attended Mr. Kayne's entering into the agreement for "expedited" arbitration;[2] and (2) The substantive unconscionability of the "expedited" arbitration procedures as TKC seeks to apply them here. In short, it is axiomatic that the evidence relevant to contract formation (consideration, acceptance by TKC's action, *etc.*) are not "substantially the same" as the evidence of substantive and procedural unconscionability presented here.

C. The Two Actions Do Not Involve "Infringement of the Same Right".

As noted, these matters involve defenses being raised by Mr. Kayne to an arbitration that has yet to occur. In the Georgia proceedings, Mr. Kayne sought to vindicate his right not to be subject to an arbitration clause when he did not, so he asserted, actually have a binding agreement to arbitrate. *See First Options of*

[2] In this regard, TKC continues to suggest that Mr. Kayne raised various arguments (including arguments based on the franchise laws) in the earlier arbitration proceedings between TKC and Kayne Art Galleries of Georgia, Inc. ("KAG"). *See* TKC's opposition brief at 5-7. By making this argument, TKC continues to ignore the rulings of Judge Illston (affirmed by the Ninth Circuit) that Mr. Kayne did *not* personally participate in that arbitration and is *not* personally bound by it. *See* Coleman Dec. in support of motion, Exhibit 5 (attaching the Ninth Circuit's decision to this effect).

Chicago v. Kaplan, 514 U.S. 938, 943-44 (1995) and *Ralph Andrews Production, Inc. v. Writers Guild*, 938 F.2d 128 (9th Cir. 1991). Here, the right (or defense) that Mr. Kayne seeks to vindicate is the one recognized for the first time in *Nagrampa* -- to be free from an arbitration clause that is unconscionable under California law.[3]

D. The Georgia Action Did Not Arise Out of the Same "Nucleus of Facts".

While it is undeniable that the Georgia action involved the same agreements (the "Personal Guaranty" and "Application for Credit") implicated here, the relevant facts in determining unconscionability are different. The issue of unconscionability simply was not presented to Judge Pannell in the Georgia proceedings, and for a very good reason—the issue did not arise until *Nagrampa* was decided by the Ninth Circuit.

III. MR. KAYNE'S DEFENSE BASED ON *NAGRAMPA* COULD NOT HAVE BEEN ASSERTED BEFORE JUDGE PANEL BECAUSE IT DID NOT EXIST AT THE TIME THE CASE WAS SUBMITTED TO JUDGE PANEL.

TKC asserts that Mr. Kayne could have, and should have, raised the unconscionability of the arbitration clause in TKC's agreements before Judge Pannell. Examination of the docket of those proceedings makes it clear that this assertion is unsustainable. *See* the Reply declaration of Charles L. Coleman

[3] In its opposition brief at 12-13, TKC seeks to portray Mr. Kayne as having "flip-flopped" on various issues. This effort depends on mischaracterizing Mr. Kayne's positions, as will be more fully explained in Mr. Kayne's opposition to TKC's motion. For present purposes, it suffices to point out that TKC's smoke screen on the applicability of California law should not obscure its admission (buried in footnote 5 , page 12 of its opposition) that TKC admits that California law applies to Mr. Kayne's defense of unconscionability under *Nagrampa*. Whether Georgia law should, indeed, apply to issues of contract formation raises questions of depecage that are beyond the scope of this case. *See generally,* Willis L.M. Reese, *Depecage: A Common Phenomenon in Choice of Law*, 73 Columbia L.Rev. 58 (1973).

("Coleman Reply Dec.") in support of temporary restraining order, attaching as Exhibit 1 a copy of that docket.

As reflected in the docket of the Georgia proceedings (Exhibit 1 to the Coleman Reply Dec.), the proceeding was removed to the district court in Georgia on September 12, 2006. The docket reflects that on October 6, 2006, TKC filed a motion to compel arbitration and to dismiss Mr. Kayne's claims. There followed a series of briefs, replies, requests for sur-reply and motions by both sides. The docket also reflects that briefing of the issues before Judge Panel – which did *not* include issues of unconscionability – was substantially completed by late November, 2006. While Judge Pannell allowed the filing of a Second Amended Complaint in March-April of 2007, this occurred pursuant to a request made months earlier.

The *en banc Nagrampa* decision was not filed until December 4, 2006, and clearly could not have come to the attention of Mr. Kayne's Georgia counsel before then. The decision clearly broke new ground in the area of unconscionability of arbitration clauses under California law, and it is difficult to understand how TKC can seriously contend otherwise. The court's *en banc* decision certainly was new to the Ninth Circuit panel whose decision was reversed, to the dissenting judges, and to numerous legal commentators who viewed it as a significant new development. It is understandable why TKC should seek to shield its yet-to-be conducted California arbitration from scrutiny under *Nagrampa*, but clearly Judge Pannell's decision regarding contract formation does not provide a sufficient basis for TKC now to proceed with a manifestly unfair and unconscionable arbitration provision.

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IV. SINCE TKC ACKNOWLEDGES MR. KAYNE HAS THE RIGHT TO RAISE UNCONSCIONABILITY DEFENSES IN ORDER TO VACATE THE AWARD, IT CAN SUFFER NO PREJUDICE BY HAVING THAT ISSUE RESOLVED NOW.

Finally, and perhaps most importantly, TKC makes the following statement or admission in its opposition brief (at page 20, lines 5-9):

> Indeed, as Kayne acknowledges, he *will have the opportunity to present* his unconscionability defenses after the arbitration. If, Kayne's unconscionabilty claim is correct (and it is not), *any arbitration award based on the unconscionable arbitration provisions in the Credit Agreement and Personal Guaranty would be vacated.* [Italics added].

If this is a correct statement of TKC's position, then it makes little sense for it to engage in such exertions to resist Mr. Kayne's motions and to dismiss his complaint, only to have the issue presented after an arbitral award.

V. CONCLUSION

For the foregoing reasons, Mr. Kayne respectfully submits that no harm will come to TKC if (as Mr. Kayne requests) the arbitration is deferred until after it is determined whether the arbitration clause on which it is based is valid under the Ninth Circuit's recently-articulated test in *Nagrampa*. This will save the parties a trip back to court after the arbitration where the same issues would be presented, and it would prevent Mr. Kayne from having to face the prospect of an arbitration in an atmosphere of uncertainty as to whether the arbitration provision on which it is based is valid.

Dated: October 4, 2007

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By: Charles L. Coleman, III

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DAVID KAYNE